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SUBJECT: SRI LANKA: RAIN HURTS RICE CROP; PRICES RISE

¶1. (SBU) SUMMARY: Torrential rains are damaging paddy yields in the main rice growing areas of Sri Lanka, with as many as 15,000 hectares lost. Domestic prices are up in wholesale markets and sharp increases in retail prices have started and will continue unless international supplies can be assured. The government has temporarily lifted import tariffs for rice in response to the shortage of domestic supply and is working to secure international commitments for rice imports. Although farmers are expected to benefit by high rice prices, the continued increase in cost for this staple food product is negatively affecting the poor. End summary.

A Weaker Harvest, in Quantity and Quality

¶2. (SBU) Sri Lanka's rice production is suffering from too much rain. Locally, rice is traditionally reaped twice a year. The major ("maha") harvest season runs from February through April, with a smaller crop brought in between October and December. The North Central and Eastern regions fill the country's rice basket, with Ampara in the east the highest rice producing district. (Note: Northern and Eastern paddy crops have long been negatively affected by the conflict.) Initial estimates by the GSL's Department of Census and Statistics placed 2008 rice production at 2.1 million tons. However the recent inclement weather will make this figure unattainable. Sri Lanka consumes approximately 2.3 million tons of rice per year.

¶3. (SBU) The Director General of Agriculture, Dr. C. Kudagamage, told Econ FSN he estimates approximately 15 percent of this year's "maha" crop will be lost. He acknowledges prices are rising due to local shortages, and are expected to continue to rise as supply is further curtailed.

¶4. (U) A drop in quality is also likely as farmers are unable to thresh the paddy during significant rain. As a result the rice remains in the paddy longer than is ideal, and quality suffers. Officials of the Department of Agriculture's Office of Extension Services estimate around 50,000 tons of harvested rice will be of inferior quality.

How Bad Is the Shortfall?

15. (SBU) The extent of the rice shortfall is a common topic of discussion as prices rise and families are forced to make hard choices about how to spend their rupees. Theories concerning the both the extent and reasons behind of the local shortage of rice abound:

-- Dr. R. Ratnayake, the Secretary of the Ministry of Commerce, believes the current shortage is primarily due to an inability to mill harvested paddy as it cannot dry properly, and because a large number of small millers are holding stock in anticipation of further price increases. He also notes that the drop in wheat flour consumption over the past year -- as a result of high prices -- has created additional demand for rice. He estimates that Sri Lanka will require an additional 200,000 tons of rice (2.4 million tons total) above last year's level to meet demand in 2008.

-- T. Pallianandy, the president of a commodity wholesale association in Colombo, feels the situation is worse and asserts that only 15 percent of the "maha" harvest has been collected to date. To illustrate, he notes that in a normal "maha" season, 25-30 truckloads of rice are delivered to the wholesale market daily. Currently, he says, only 3-4 trucks arrive each day. He adds that the heavy rains have also flooded many small stores, causing a loss of previously harvested rice. He also believes many millers and traders are holding on to rice stocks, hoping for further price hikes.

-- Managing Director of Cargills Ceylon Ltd Ranjith Page, whose company operates more than 100 retail food outlets and accounts for 4 percent of total rice traded domestically, claims that 30 percent of the rice crop has been destroyed. In addition, he says 20 percent of the harvest is afflicted by poor quality.

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Government Action

16. (U) Expecting that prices will rise sharply in the next few months, the government is taking action now to ensure a steady flow of imported rice to ease local shortages and price escalations. However, with global production scarcity and countries such as Vietnam, Thailand, and India prohibiting rice exports in an effort to cope with their own domestic needs, cheap imports are unlikely to be widely available.

17. (U) The government has found at least one willing partner. Following a plea from President Rajapaksa, India agreed -- despite its ban -- to export 100,000 tons of rice to Sri Lanka. (Note: In 2007, Sri Lanka imported just over 70,000 tons from India.) However, concerns about the price at which it will be exported remain, and it will not be enough to meet Sri Lanka's needs. As a result, the GSL is also making appeals to Pakistan and Burma for rice supplies. Trade Minister Bandula Gunewardene recently traveled to Burma to plead for 100,000 tons of rice exports in 2008, and discussions with Pakistan could add another 50,000 tons to Sri Lanka's supply if successful. However, according to Pallianandy, Pakistani rice varieties are not suitable for local consumption, and its wholesale prices are too high.

Prices and Impact on Farmers

18. (SBU) Without assurances for international rice availability and lacking a full picture of the extent of local damage, it is difficult to predict how high rice prices could go. In December 2007, one kilo of rice sold for approximately 55 rupees (\$0.53). At present, the same kilo goes for 80 rupees (\$0.77). Cargills MD Page believes that prices could rise to as much as SR 140 (\$1.30) in the next few months. The burden on low income families will be significant.

19. (U) Farmers are faring well, with many benefiting due to the shortage. Those who held off on selling their harvest from late

2007, and/or those minimally affected by the rains are now fetching high prices for their crop. Many also continue to hold on to stocks in the hope that prices will rise even further. In some cases, these high prices may more than make up for their "maha" losses.

Comment: Weather is the Proximal Cause, but
Government Policies Exacerbate Problems

¶10. (SBU) The current shortage is not yet a crisis, but it could easily reach that level if the government is unsuccessful at securing additional supplies. However, the government has itself partly to blame for the current situation. Agriculture contributes approximately 16% to Sri Lanka's GDP, and provides employment for around 30% of the population. Unless the government and private sector focus on better technologies to enhance production, Sri Lanka's domestic production will continue to lag, with or without additional inclement weather concerns. The government currently spends millions of dollars annually on fertilizer subsidies with negligible results. These funds could be better utilized to transfer proper agricultural practices to farmers and to build infrastructure and market linkages. Mismanagement and corruption among government agencies also exacerbate problems. Recently, rice imported to be distributed through the government's cooperative system was discovered to be sold through private traders. Unfortunately, despite these concerns, the government appears too preoccupied with the conflict to address these issues. The high rice prices will add to Sri Lanka's already high inflation, resulting in continued difficult times for Sri Lanka's poor.

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